UNITED
NATIONS

TD

United Nations
Conference
on Trade and
Development

Distr.
GENERAL

TD/B/SEM.2/1
8 April 1997

Original : ENGLISH

TRADE AND DEVELOPMENT BOARD
Pilot Seminar on the Mobilization of the
Private Sector in order to Encourage
Foreign Investment Flows towards the
Least Developed Countries (LDCs):
"Investment Opportunities in Pre-Emerging Markets"
(UNCTAD/UNIDO)
Geneva 23-25 June 1997
Item 2 of the provisional agenda

PROVISIONAL AGENDA AND ANNOTATIONS TO THE PROVISIONAL AGENDA

I. Provisional agenda

1. Election of officers

2. Adoption of the agenda

3. Consideration of issues related to the mobilization of the private sector for the promotion of foreign investment flows towards the least developed countries (LDCs)

4. Adoption of the report

GE.97-50678

II. Annotations to the Provisional Agenda

Item 1: Election of officers

1. It is recommended that the Pilot Seminar elect a Chairman and a Vice-Chairman-cum-Rapporteur.

Item 2: Adoption of the agenda

2. The provisional agenda for the Seminar is in section I above. The schedule of meetings for the three days is attached to this document.

Documentation

TD/B/SEM.2/1 Provisional agenda and annotations to the provisional agenda

Item 3: Consideration of issues related to the mobilization of the private sector for the promotion of foreign investment flows towards the least developed countries (LDCs)

3. Pursuant to paragraph 89(g) of "A Partnership for Growth and Development", UNCTAD and UNIDO are co-sponsoring the organization of the Pilot Seminar on the Mobilization of the Private Sector in order to Encourage Foreign Investment Flows towards the Least Developed Countries.

4. For the consideration of this item, the Seminar will have before it a report prepared by the UNCTAD secretariat. The report draws on two background staff papers: "Experiences on country funds and venture capital funds in developing countries" (UNCTAD/GDS/GFSB/1) and "Prospects for and constraints on foreign investment in LDCs" (UNCTAD/GDS/GFSB/2), which include replies to questionnaires sent to LDCs and investment fund managers.

5. The issues to be considered will include: (a) prospects for, and constraints on, foreign investment flows to LDCs, through investment funds such as country funds and venture capital

funds; (b) investment opportunities in LDCs by country and by sector; (c) conditions for the creation of investment funds for LDCs.

6. Studies will be made available to participants on investment opportunities in LDCs in the three sectors: infrastructure, agro-industries and tourism. These studies are being prepared by UNCTAD/UNIDO, under Technical assistance project INT/97/A12, financed by the Government of Norway.

7. UNIDO has also prepared information on investment opportunities in seven LDCs (Bangladesh, Burkina Faso, Madagascar, Togo, Uganda, United Republic of Tanzania and Zambia), as well as on opportunities offered by privatization schemes in Africa.

Documentation

TD/B/SEM.2/2	Issues for consideration in the mobilization of the private sector for the promotion of foreign investment flows towards the least developed countries (LDCs)

Item 4 Other business

Item 5. Adoption of the report

8. The Seminar will adopt its recommendation/findings at the end of the meeting. The final report will be compiled under the authority of the Chairman after the conclusion of the meeting.

Annex

Schedule of meetings

Day 1	Day 2	Day 3
10 a.m. Plenary - Opening of the Seminar by Director - Election of officers - Adoption of agenda **Followed by** Informals: Substantive item 3 (a). Prospects for and constraints on foreign investment in LDCs	10 a.m. Informals : Substantive item 3 (b). Investment opportunities in LDCs	10 a.m. Informals: Substantive item 3 (c). Conditions for the creation of investment funds in LDCs
3 p.m. Informals: Item 3 - (continued)	3 p.m. Informals: Item 3 - (continued)	3 p.m. Informals: Substantive item 3 - (continued) Plenary (closing) Adoption of recommendation/findings

UNITED
NATIONS

TD

United Nations
Conference
on Trade and
Development

Distr.
GENERAL

TD/B/SEM.2/2
10 April 1997

Original : ENGLISH

TRADE AND DEVELOPMENT BOARD
Pilot Seminar on the Mobilization of the
Private Sector in order to Encourage
Foreign Investment Flows towards the
Least Developed Countries (LDCs)
"Investment Opportunities in Pre-Emerging Markets"
(UNCTAD/UNIDO)
Geneva 23-25 June 1997
Item 3 of the provisional agenda

CONSIDERATION OF ISSUES RELATED TO THE MOBILIZATION OF THE PRIVATE SECTOR FOR THE PROMOTION OF FOREIGN INVESTMENT FLOWS TOWARDS THE LEAST DEVELOPED COUNTRIES (LDCS)

Note by the UNCTAD secretariat

CONTENTS

		Paras
	Introduction	1-6
I.	Types of investment vehicles	7-27
II.	Prospects for and constraints on to foreign investment in LDCs	28-41
III.	Identification of investment opportunities in LDCs	42-45
IV.	Organization of work	46-47

GE.97-50699

INTRODUCTION

1. In "A Partnership for Growth and Development", adopted at UNCTAD IX, it was agreed that UNCTAD should focus, inter alia on "facilitating, consistent with available resources, the holding of a pilot seminar, co-sponsored with other relevant international organizations, on the mobilization of the private sector in order to encourage foreign investment flows towards the least developed countries. The results of this seminar should be evaluated by the Trade and Development Board in order to determine further action in this regard" (TD/378, para.89(g)).

2. Based on this mandate, the Secretary-General of UNCTAD and the Director-General of UNIDO agreed, in a communiqué issued on 25 July 1996, that the two organizations would co-sponsor the Pilot Seminar, given the complementarity of the two organizations and their specific expertise. Other multilateral organizations are also invited to participate in the work of the Seminar.

3. Given the broad mandate set out in "A Partnership for Growth and Development", this note has been prepared with a view to identifying issues for a more focused and action-oriented discussion at the Seminar.

4. Issues to be discussed at the Seminar are related to the prospects for and constraints on foreign investment in LDCs. Foreign investment in this context is to be distinguished from the traditional foreign direct investment of transnational companies and refers to innovative financing arrangements in the form of equity investment funds, such as country funds and venture capital funds.

5. The following issues will be considered:

(a) The suitability of various forms of innovative financing arrangements (country funds and venture capital funds) for the mobilization of foreign risk capital for investment in LDCs;

(b) Prospects for and constraints on to foreign investment in LDCs;

(c) Identification of investment opportunities in LDCs, by country and by sector;

(d) Conditions for the creation of investment funds for LDCs and identification of technical cooperation activities.

6. This note will outline the first three issues, while the conditions that form the subject of the fourth issue will emerge from the discussion at the Seminar. Participants in the Seminar might identify areas of investment in LDCs where further feasibility studies can be undertaken, as well as areas where technical cooperation is needed in order to make the conditions move favourable for the promotion of foreign investment.

I. TYPES OF INVESTMENT VEHICLES

The setting

7. In recent years, interest has focused on the role of non-FDI foreign investment in emerging markets in the financing of the enterprise sector of the countries concerned. Non-FDI flows are mainly equity investments in the capital of local companies in emerging markets. These investments are made by financial institutions, institutional investors (such as pension funds, insurance companies or investment trusts), or individuals interested in the financial returns of these investments.

8 The trend in foreign equity investment flows to developing countries in recent years suggests that these flows are becoming a significant source of external finance for investment. For the three years 1993-1995, total equity investment flows, including quasi-equities like convertible bonds and bonds with equity warrants, were equivalent to nearly half the FDI flows to developing countries and countries in transition[1]. The surge in equity investment in emerging markets took place against a background of structural changes in international capital markets and in the economies of recipient countries.

9 The recent period has been characterized by a seemingly irreversible process of globalization of financial markets. Financial market liberalization, as well as advances in information and communication technology, have allowed cross-border flows of capital to move swiftly between different parts of the world. The volume of these capital investments has also increased rapidly with the participation of institutional investors in the markets. The increasing importance of institutional investors, reinforced by demographic and institutional factors in OECD countries, has tended to alter the nature of financial markets. It has been estimated that insurance companies, pension funds and mutual funds in the six largest industrial countries were holding a pool of savings of nearly US$ 20 trillion in 1993[2]. In comparison, global equity market capitalization in the same year was US$ 14.1 trillion. However, it is estimated that the average share of emerging market securities in institutional investors' portfolios is only 1 per cent[3]. There is thus room for further increases in foreign equity investment in emerging markets.

10. Between 1985 and 1995, emerging stock market capitalization grew more than tenfold from US$ 171 billion to US$ 1.9 trillion, and the pace of development was much faster than that of developed markets. As a result, emerging markets' share of world stock market capitalization increased from 3.6 per cent to 12.6 per cent. At the end of 1995, emerging markets listed and traded over 17,000 companies, equivalent to about 90 per cent of the number of companies listed in developed markets.

---

[1]See analysis of equity investment trends in UNCTAD: World Investment Report 1997, forthcoming, Part I. Chapter 3, "Foreign portfolio equity investment".

[2]Baring Securities: Cross Border Equity Flows, Volume II, A report by Michael Howell, Angela Cozzini, Mark Clayton (London, July 1995), p.58.

[3]IMF: International Capital Markets, 1995, p.172.

11. Foreign equity investment is made through direct purchases by individual investors of shares of companies listed in the stock markets of emerging markets, purchases of international equity offerings (including American deposit receipts (ADRs) or global deposit receipts (GDRs)) issued by companies from emerging markets on international capital markets, or investments through country funds and venture capital funds. The first two forms of investments are less frequent in low-income countries. Stock markets in these countries, if they exist, are in a nascent stage, and hence often illiquid and volatile; individual investors would therefore not take the risk of investing directly, as they are not as well informed as professional institutional investors. ADRs and GDRs are in general accessible only to large well known companies from fairly developed emerging markets which can meet the strict disclosure and reporting requirements applied to such international equity issues. Country funds and venture capital funds are thus the most common forms of equity investment in developing countries and those which can benefit the LDCs.

Country funds[4]

12. There has been an explosion in investment in emerging markets through investment mutual funds. From 1984 to 1996, the total number of international emerging market equity funds grew from 10 to 1,435, while the net asset value of such funds increased from US$ 1.3 billion to US$ 135 billion. In 1996, there were 298 global funds, 775 funds in Asia, 239 in Latin America, 88 in emerging European markets and 35 in Africa and the Middle East (see table 1). Asia accounts for the largest share of the total net asset value of emerging market equity funds (48%), followed by Latin America (10.5%) and emerging European markets (3%), while Africa and the Middle East account for only one per cent. The distribution of these equity funds is, thus, strongly skewed towards emerging markets with large market capitalization or high growth prospects.

13. Mutual funds, whether global, regional or country-specific, have become the most popular form of portfolio equity investment in emerging markets. The concept of the mutual fund relies on a large pool of investors and the managed investment of their funds in financial assets, primarily in the form of money and capital market instruments. Funds often list their shares on a stock exchange other than the market in which the money is invested. Funds are on-shore when they are listed in the same market as they are invested.

14. Mutual funds may seek income, capital appreciation, or balanced growth by investing in a variety of instruments. There are two types of mutual equity funds: open-end and closed-end funds. Closed-end funds issue a fixed number of shares, while the number of shares offered by open-end funds varies on demand. In addition, open-end funds are required to redeem claims on demand, which explains the much higher turnover ratios of open-end funds than closed-end funds. For this reason, open-end funds tend to invest in larger firms which offer more liquid securities.

15. Because closed-end funds are not required to meet redemption requests or to expand in order to meet investors' demand for further subscription for shares, their structure is such that

---

[4]This section is largely based on the analysis contained in Part I, Chapter 3, of the forthcoming World Investment Report 1997.

Table 1

International emerging equity funds: Total net assets of global, regional and country funds (US$ millions)

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	*1996	No. of Funds**
Asian regional	*400*	*1'234*	*1'750*	*3'100*	*4'000*	*5'350*	*8'000*	*21'500*	*32'661*	*34'800*	*40'125*	375
Bangladesh	0	0	0	0	0	0	0	0	20	21	31	1
China and China-concept	0	51	47	50	60	110	1'300	3'220	4'000	5'914	6'680	108
India	200	208	270	300	830	970	1'090	2'055	4'195	3'000	3'450	60
Indonesia	0	0	35	260	525	400	440	860	729	680	597	27
Korea, Republic of	700	885	990	1'215	1'205	1'310	1'710	3'420	5'406	5'700	5'150	94
Malaysia	0	56	75	240	505	600	620	995	1'345	918	875	20
Myanmar	0	0	0	0	0	0	0	0	25	28	60	2
Pakistan	0	0	0	0	0	65	65	310	276	113	98	6
Philippines	15	39	45	280	240	290	350	670	655	551	654	13
Sri Lanka	0	0	0	0	0	0	0	30	58	41	32	3
Taiwan, Province of China	136	151	380	600	475	890	925	1'860	3'028	2'750	3'953	29
Thailand	165	170	845	1'390	1'400	1'580	1'920	2'860	2'862	3'000	2'855	31
Viet Nam	0	0	0	0	0	10	30	50	273	368	386	6
Asian regional and country	***1'616***	***2'794***	***4'437***	***7'435***	***9'240***	***11'575***	***16'450***	***37'830***	***55'533***	***57'884***	***64'946***	775
Latin American regional	*0*	*0*	*0*	*175*	*380*	*1'510*	*2'000*	*5'200*	*10'919*	*8'500*	*9'750*	155
Argentina	0	0	0	0	0	115	105	170	214	212	230	6
Brazil	0	63	220	320	165	380	485	625	1'854	1'350	1'497	53
Chile	0	0	0	160	380	740	850	1'115	1'683	1'620	1'200	7
Columbia	0	0	0	0	0	0	17	63	33	28	40	2
Mexico	200	225	300	330	530	780	1'040	1'865	1'783	1'060	1'348	12
Peru	0	0	0	0	0	0	20	30	52	41	48	3
Venezuela	0	0	0	0	0	0	0	0	0	1	1	1
Latin American Regional and Country	***200***	***288***	***520***	***985***	***1'455***	***3'525***	***4'517***	***9'068***	***16'538***	***12'812***	***14'114***	239
European Regional	*0*	*0*	*0*	*15*	*103*	*127*	*150*	*168*	*792*	*977*	*1'950*	40
Baltic Republics	0	0	0	0	0	0	0	0	15	34	43	2
Czech Republic	0	0	0	0	0	0	29	30	132	165	244	7
Greece	0	0	70	70	130	120	100	95	78	70	73	1
Hungary	0	0	0	75	191	200	205	205	230	201	240	2
Poland	0	0	0	0	0	0	0	0	0	18	80	2
Portugal	0	25	50	225	230	225	225	275	324	323	306	5
Russian Federation	0	0	0	0	0	0	0	0	222	488	1'250	26
Turkey	0	0	0	115	115	90	80	145	119	113	130	3
European regional and country	***0***	***25***	***120***	***500***	***769***	***762***	***789***	***918***	***1'912***	***2'389***	***4'316***	88
African and Middle East regional	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*30*	*323*	*440*	*468*	15
Egypt	0	0	0	0	0	0	0	0	0	0	150	3
Mauritius	0	0	0	0	0	0	0	18	34	28	24	1
Morocco	0	0	0	0	0	0	0	2	58	43	46	3
Oman	0	0	0	0	0	0	0	0	26	26	30	1
South Africa	80	100	115	125	500	550	665	595	935	1'085	1'082	12
African, Middle East regional and country	***80***	***100***	***115***	***125***	***500***	***550***	***665***	***645***	***1'376***	***1'622***	***1'780***	35
Total regional and country	**1'896**	**3'207**	**5'192**	**9'045**	**11'964**	**16'412**	**22'421**	**48'461**	**75'359**	**74'707**	**85'156**	1137
Global funds	***70***	***592***	***900***	***1'350***	***2'300***	***3'750***	***7'750***	***24'750***	***34'716***	***36'000***	***49'500***	298
Total regional, country and global	**1'966**	**3'799**	**6'092**	**10'395**	**14'264**	**20'162**	**30'171**	**73'211**	**110'075**	**110'707**	**134'656**	1435

* All data are as at 31 December except for 1996 which is as at 30 September

** No. of Funds as at 30 September 1996

Source Micropal

Note: the designation "country" covers countries and territories.

their investments are more stable and not too sensitive to market volatility. Capital commitment by a closed-end fund can sometimes last over a period of 10 years or more, and investment can be made in lesser-known and less liquid securities. However, closed-end funds will naturally adjust their portfolio of investments in emerging markets, selling and purchasing local securities in a manner consistent with the maximisation of returns of their portfolio.

16. Since the first emerging market fund, the Mexico fund, was launched with a listing in the New York Stock Exchange in 1981, closed-end funds have become the dominant form of investment in emerging markets. In the beginning, closed-end country funds were set up to invest in countries that were largely closed to foreign investment (for example, the Republic of Korea fund launched in 1984) or in countries where foreign investors found it administratively difficult to invest. The International Finance Corporation (IFC) has been a leading sponsor of many closed-end funds investing in emerging market securities. The Commonwealth Development Corporation has also launched several equity funds to invest in emerging markets. Closed-end funds are also established by investment banks, investment management firms, host country Governments (with contributions from multilateral financial institutions and private investors), or groups of individual investors.

17. Country equity funds are most of the time invested in countries with stock markets. Investments are made in listed companies, and sometimes in unlisted companies with the expectation that capital gains will be reaped from the subsequent listing of such companies on stock markets when they become mature. Some country funds (such as the Viet Nam funds) are set up for investment in developing countries which have not organised a formal stock market, in anticipation of the establishment of such a stock market which would allow divestment.

18. A survey of investors' motivations[5] indicates that among the factors which determine market selection by investors, three are the most often cited: growth potential, a favourable environment for foreign investment (political and macroeconomic stability, investors' protection), and ease of capital and income repatriation. Other factors include market liquidity, local market history (volatility), and the valuation of local currency (over/undervaluation).

Venture capital funds[6]

19. Venture capital (VC) usually provides funding for new or high-risk ventures with prospects for high growth and profitability. Venture capital financing provides early-stage financing, as well as financing for expansion of established companies. The objective of investing only in ventures with high potential returns means that VC investors must screen investment proposals closely. The evaluation of VC investments characteristically focuses on whether (a) the

---

[5]This survey is based on a questionnaire sent out by UNCTAD to fund managers to investigate investors' motivations and market selection process.

[6]More detailed analysis and information on country funds and venture capital funds are contained in a paper prepared by the UNCTAD secretariat on "Experiences on country funds and venture capital funds in developing countries" (UNCTAD/GDS/GFSB/1).

entrepreneur has a credible business plan and (b) whether he/she has the ability to implement it successfully.

20. VC investing typically involves the participation of the VC institution in the investee company. This is motivated both by the need to protect the VC institution's investment against downside risks, particularly because the investor cannot simply sell out his investment (in unlisted shares) if performance is poor, and by the aim of adding value to the investee company by contributing the VC firm's experience and contacts in such areas as business strategy, management organisation and processes, financial planning and control, and investor relations.

21. The final and critical phase of the VC investing cycle is to manage the divestment or exit from the firm where the investment was made. Since realising a substantial capital gain is essential to achieving high investment returns, determining the timing and conditions of the sale of investments is a key element of the VC process. There are three basic exit routes:

- Floatation of the company through an initial public offering (IPO) of shares to the public on a stock exchange or on the over-the-counter market;

- Secondary or "trade sale" of the VC investor's shares to another investor or company. This is probably the most commonly used route, although in larger developed countries the transaction is often initiated by the acquiring investor who has identified the company as having a good strategic fit with its own operations;

- Repurchase of the VC institution's shares by the entrepreneur or the investee firm. The original contractual agreements between the investors may provide for this possibility and define the conditions for the buy-back of shares.

22. Since the late 1980s, there has been a multiplication of specialized VC institutions investing in emerging markets. Many of these are structured as two-tier investment funds, with management provided by professional fund managers from international capital centres. While VC institutions have been established in many countries, including several LDCs (Bangladesh, Madagascar, Mozambique and Uganda), the major expansion has been concentrated in Asia and the transition economies of Central and Eastern Europe.

23. Over the last two decades, the IFC has promoted venture capital funds in developing countries in an effort to improve the access of small and medium-sized enterprises to equity finance and management expertise. IFC has worked with institutional investors, investment banks and fund managers in structuring funds, identifying fund managers and placing funds. By 1996, it had invested US$ 196 million in 49 venture capital funds, with a total initial capital of US$ 1.5 billion.

24. The Commonwealth Development Corporation (CDC) has also expanded its VC activities in developing countries, in particular by promoting VC funds to provide start-up capital to companies in eight African countries (Ghana, Kenya, Mozambique, South Africa, Uganda, United Republic of Tanzania Zambia and Zimbabwe). These funds are generally smaller (US$ 10-15 Million) than those in which IFC has invested and are managed directly by CDC.

25. The experience of VC investment in developing countries has been mixed. The successes and failures point to some important lessons for the wider use of this type of financing mechanisms in the future.

26. VC funds need to be able to identify a substantial number of firms offering high returns on investment (at least 25 per cent). The market for equity financing depends on several conditions: stable macro-economic conditions to stimulate investment in setting up or expanding new ventures; and entrepreneurs with adequate management skills, business experience and understanding of the "equity culture" necessary for the partnership between promoter and outside investors, i.e. a willingness to provide financial information, to respect the contractual rights of all shareholders, and to allow some degree of external control over the business.

27. The regulatory framework in the recipient country should also provide investors with an attractive tax regime, allowing a substantial proportion of the appreciation in value of the investee firms to be transferred to investors; legal transparency; and freedom from exchange control restrictions.

II. PROSPECTS FOR AND CONSTRAINTS ON FOREIGN INVESTMENTS IN LDCs

28. Surveys of investors' market selection process point to a number of factors which are taken into consideration by investors when they invest in emerging markets:

- Macro-economic and political stability is invariably the precondition for foreign investment, as it provides a stable environment for the promotion of risk capital investment in high-risk ventures. In particular, stable exchange rates would protect investors from exchange risk;

- High growth potential: experience has shown that most equity investment funds are concentrated in markets with high growth potential;

- Ease of capital and income repatriation: investors should be assured that the income and capital gains of their investments can be easily repatriated. In that respect, foreign exchange control is a major impediment to foreign investment;

- Legal transparency and adequate investors' protection;

- Adequate financial information and reporting disclosure;

- Exit mechanisms: portfolio equity investors are interested in the financial returns on their investments and, hence, prefer to invest in more liquid instruments. The usual exit mechanism for divestment is the stock exchange. Hence, the existence of liquid stock exchanges is an advantage. However, in the case of venture capital investment, other exit mechanisms can be used: secondary or "trade sale" of the investor's shares to another investor or company, or repurchase of the investor's

shares by the entrepreneur of the investee firm, as allowed by contractual agreements;

- In countries which have a stock market, investors also look at such factors as market liquidity (as measured by ratios of market capitalization to money supply) and the volatility of the stock market.

Investment environment in LDCs

29. Since the early 1980s, a large number of LDCs have embarked on a process of stabilization and structural adjustment. Although this has not been a very easy endeavour, as some of the programmes have not as yet yielded the expected results, the overall economic outlook for LDCs as a group has improved in the 1990s as compared with the previous decade.

30. Thus, in 1995-1996 LDC economies displayed some noticeable progress, with annual GDP growth rates estimated at 3.2 per cent, as compared with an average growth rate of 2.2 per cent over the period 1980-1990[7]. Of the 48 LDCs, at least 14 experienced strong economic expansion in 1995, with GDP growth exceeding 5 per cent. Barring adverse weather conditions, LDC growth in 1996 should be sustained and reach the same level as in 1993, notwithstanding the expected weakening of certain commodity prices.

31. Inflation has also been reduced. In 1995, LDCs' average inflation rate was 23.9 per cent; although still high, this compared well with an average rate of 35.7 per cent over the period 1991-1994. The inflation rate is projected to decrease further and reach 19.2 per cent in 1996 and 13.2 per cent in 1997[8]. The central government fiscal deficit, in per cent of GDP, was also reduced to 5.6 per cent in 1995, as compared with 9.5 per cent in 1988. The fiscal deficit, on average, is projected to remain at around 5 and 6 per cent in 1995/1996.

32. Important policy reforms have been implemented in the financial sectors of many LDCs in recent years.[9] Financial systems have been liberalized, with the reduction or removal of allocative controls over interest rates and lending, the introduction of market-based techniques of monetary control, and the easing of entry restrictions in domestic financial markets. Restructuring programmes have started to address the problem of financial fragility of parastatal banks, and banking laws and supervision have been strengthened.

---

[7] UNCTAD: The Least Development Countries 1996 Report (United Nations document, Sales No. E.96.II.D.3).

[8] IMF: World Economic Outlook, October 1996, Table A11, p. 181.

[9] See UNCTAD: The Least Developed Countries 1996 Report, Part Three: Financial Sector Reforms in LDCs, pp. 87-105.

33. Financial sector reforms seem to have born fruit: the real rates of interest improved from -4.1 per cent in 1983-89 to -2.4 per cent in 1990-95[10]. Financial market reforms might have increased the volume of financial intermediation and financial savings and contributed to an increase in investment. Investment in per cent of GDP increased from 14.8 per cent in 1983-89 to 16.0 per cent in 1990-95.

34. In a number of LDCs, foreign exchange controls have been relaxed or completely abolished[11], and in some others forex bureaus[12] have been established in order to handle foreign exchange transactions which are no longer controlled by central banks.

Capital market development

35. Although a large number of LDCs are now actively trying to promote the creation of domestic securities markets, it is nevertheless a difficult and delicate process. For securities markets to operate with some degree of efficiency, the conditions are a stable macro-economic environment, a proper financial and capital market infrastructure, and an adequate regulatory, legal and supervisory framework which should protect investors, promote public confidence and guarantee market discipline[13].

36. First, prudential standards should establish capital adequacy requirements, safekeeping of securities and financial reporting requirements for intermediaries, as well as a system for monitoring and enforcing such requirements.

37. Second, measures should be implemented to protect investors from market manipulation and lack of transparency. These include rules on information disclosure, clarity of contractual relationships and strict fiduciary responsibility. Regulations on information disclosure include an effective legal system to specify and enforce disclosure standards for all companies issuing securities to the public and listing securities for secondary trading on stock exchanges.

38. In addition, these laws and rules should be backed up by the adoption and use of generally accepted accounting principles and auditing standards by an accounting profession which adheres to internationally accepted standards. The International Accounting Standards (IAS) are gaining recognition by the securities profession, notably by the International Organization of Securities

---

[10]IMF: World Economic Outlook, October 1996, Table 17, p.74.

[11]For example in Djibouti, Gambia, Maldives, Uganda.

[12]For example in Guinea, Lao People's Democratic Republic, Sudan, Uganda, United Republic of Tanzania, Zambia.

[13]For a short discussion of the requirements for an adequate legal and regulatory framework, see: UNCTAD: "Foreign portfolio equity investment in developing countries: current issues and prospects", TD/B/WG.1/11, 26 October 1993, p.25-26.

Commissions (IOSCO). Available information indicates that in some LDCs, such as Guinea-Bissau, Lesotho, Malawi, Mali and Sudan, the financial reporting rules are consistent with IAS. At the regional level, the Southern African Development Community (SADC) is implementing regionally and internationally acceptable accounting standards through the harmonization of national accounting procedures.

39. Third, there should be organizational controls that provide for the establishment and operation of stock exchanges, clearing houses and market information systems.

40. Although still at a nascent stage, stock exchanges have been established in some LDCs, for example Bangladesh, Bhutan, Malawi, Nepal, Zambia and the United Republic Tanzania. By January 1997, the Dhaka Stock Exchange (Bangladesh) had 185 companies and its market capitalization had reached US$3,865 million. In 1991, the Government established a Securities and Exchange Commission and accorded tax exemption on capital gains. Information on the Stock Exchange of Nepal indicates that, by February 1997, there were 91 companies listed and market capitalization had reached about US$ 200 million.

41. In many LDCs, the economy is too small to justify the cost involved in setting up an efficient stock market. In these cases regional cooperation on capital market development may help to improve the mobilization of both local and foreign resources for the financing of a sufficiently large number of companies, thus providing a wider choice of stocks and more market liquidity. However, establishment of regional capital markets or stock exchanges would require intensified efforts for the harmonization of accounting and reporting systems, tax regulations, and monetary and financial policies.

III. IDENTIFICATION OF INVESTMENT OPPORTUNITIES IN LDCs

42. In view of the improving economic situation in many LDCs, these countries can attract more risk capital investment. Very often the existence of rich natural resources which are still under-exploited or not exploited as efficiently as possible gives investors an opportunity to realize potentially high returns. This dormant potential has been given additional attractiveness by a liberalization process which has eased foreign investors' access to these countries' markets. However, though investment opportunities exist in LDCs, most investors are still keeping their distance from these markets because of lack of information, misconceptions to varying degrees about LDC markets, and also the high costs associated with the search for the best opportunities in these often small markets.

43. Lately there seems to have been an increase in interest on the part of foreign investors in some LDCs, as witnessed by the closed-end country funds which have been launched these last years to invest in Bangladesh, Madagascar, Myanmar, and the United Republic of Tanzania. A number of regional funds have also been launched to invest in Africa[14].

---

[14]For example, Morgan Stanley's Africa Investment Fund, the Africa Emerging Markets Fund (an offshore fund managed in the United States), and the Regent Undervalued Assets Africa Fund. See: The Economist: "African stock markets, No joke", 11 January 1997.

44. The purpose of the Seminar is to identify investment opportunities and to present them for discussion with participants from the private sector. In particular, UNCTAD and UNIDO will present specific investment opportunities in the agro-industry, tourism and infrastructure sectors, as well as investment projects in specific LDCs. Agriculture is the mainstay for most of the LDCs, and agro-related industries (including textiles) play an important role in the economic and industrial development of these countries. For some countries, especially islands, tourism is an appreciable source of income. Infrastructure development can also represent investment opportunities for foreign investment, as the trend is towards the privatisation of such investment.

45. Opportunities offered by privatization schemes will also be examined. The examples found in Latin America and Central and Eastern Europe have shown that privatization can be a driving force in the development of domestic securities markets. Privatization also attracts foreign risk capital investment. In the LDCs, several privatization schemes are being implemented[15]. These can attract foreign investment through, for example, the launching of a privatization fund.

IV. ORGANIZATION OF WORK

46. The method of work of the Pilot Seminar will be based on the active participation of representatives from Governments, multilateral institutions, and actors from the private sectors, including representatives of private companies from LDCs and, on the investor side, managers of private banks and investment funds. The discussion should be action-oriented, leading to recommendations on policies to enhance the investment environment and capital market development and on conditions for the creation of investment funds in LDCs.

47. As it is expected that extensive interactions between investors and countries will take place, especially concerning the examination of investment opportunities in LDCs, it is also hoped that business contacts will be established which will encourage further investment, through equity funds in LDCs.

---

[15]For example, in Burkina Faso, Mozambique, Zambia and Bangladesh. Other LDCs have announced their intention to privatize large parts of their industrial sector.